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In the Supreme Court of the United States

October Term, 1993

RIVERSIDE NATIONAL BANK, MICHAEL C. BILLINGS, MARYANN ARCHAMBAULT, J. RICHARD SWARTZ, and ROY E. WHITEHEAD,

Petitioners,

v.

NICHOLAS E. TAVAGLIONE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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EDITOR'S NOTE

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for the County of Riverside

No. 93-1640

In the Supreme Court of the United States

October Term, 1993

RIVERSIDE NATIONAL BANK, MICHAEL C. BILLINGS, MARYANN ARCHAMBAULT, J. RICHARD SWARTZ, and ROY E. WHITEHEAD,

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NICHOLAS E. TAVAGLIONE,

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

To the Honorable William H. Rehnquist, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

Petitioners, Riverside National Bank, Michael C. Billings, Maryann Archambault, J. Richard Swartz, and Roy E. Whitehead, defendants in the lower courts, submit this brief pursuant to rule 15.6 of the *Rules of the Supreme Court of the United States*, in response to the opposition brief filed by respondent Nicholas E. Tavaglione on or about May 16, 1994. It is respectfully urged that certiorari should be granted to resolve the important issues presented by the defendants. The opposition brief filed by plaintiff Nicholas E. Tavaglione presents a misleading and inaccurate view of the law and of the record.

I.

Under California Law, Breach of Contract and Breach of the Covenant of Good Faith and Fair Dealing Are Separate and Distinct Legal Theories, and the Plaintiff Here Has Relied Only on the Latter Theory, Which Is Unsustainable.

In his opposition brief, plaintiff Tavaglione has assumed in his argument that breach of contract and breach of the covenant of good faith and fair dealing are essentially the same thing. Therefore, he reasons, it is appropriate to uphold a judgment based on a contract theory, even though no such theory was ever pursued, where the plaintiff did sue for breach of the implied covenant of good faith and fair dealing. This argument is untenable.

Over the course of many years, California courts have developed the independent theory of breach of the covenant of good faith and fair dealing as a tort cause of action, which is related to, but separate from, any claim for breach of contract.

The covenant of good faith and fair dealing is read into contracts in order to protect the express promises of the contract. An implied covenant is simply "an implied in law term of the contract." *Careau & Co. v. Security Pacific Business Credit, Inc.*, 222 Cal.App.3d 1371, 1393, 222 Cal.Rptr. 387 (1990). Thus, a breach of the covenant "will always result in a breach of the contract, although a breach of a consensual (i.e., an express or implied in fact) contract term will not necessarily constitute a breach of the covenant." 222 Cal.App.3d at 1393-1394.

Far from imposing new obligations and corresponding benefits, the implied covenant simply "requires each of the contracting parties to refrain from doing anything to injure the right of the other to receive the benefits of the agreement." *Gaffney v. Downey Savings & Loan Association*, 200 Cal.App.3d 1154, 1171, 246 Cal.Rptr. 421 (1988); *Seaman's Direct Buying*

Service, Inc. v. Standard Oil Company, 36 Cal.3d 752, 768, 206 Cal.Rptr. 354, 686 P.2d 1158 (1984).

A court may not use the implied covenant of good faith and fair dealing as a pretext for inserting a new term into the contract. " 'A covenant will not be implied against express terms or to supply a term on a matter as to which a contract is intentionally silent.' (1 Witkin, Summary of Cal. Law (8th ed. 1973) Contracts, §580, p. 497.)" *Witt v. Union Oil Company*, 99 Cal.App.3d 435, 441, 160 Cal.Rptr. 285 (1979). In other words, "the duty to act in good faith does not alter the specific obligations of the parties under the contract." *Balfour, Guthrie & Company v. Gourmet Farms*, 108 Cal.App.3d 181, 190, 166 Cal.Rptr. 422 (1980). Therefore, "[a]cts in accord with the terms of one's contract cannot without more be equated with bad faith." 108 Cal.App.3d at 191.

In the present case, according to the operative pleading of the plaintiff, the supposed covenant of good faith and fair dealing arose from the relationship of the parties. In particular, the plaintiff contended that his status as a shareholder, as a borrower, and as a director of the Riverside National Bank resulted in the existence of an implied covenant. All three of these supposed grounds for the existence of the covenant have failed.

At trial, the plaintiff abandoned any contention that mere ownership of stock gave rise to a covenant of good faith and fair dealing. Since the relevant loan documents omitted any obligation to renew existing loans, and in light of the authorities cited above, it became impossible to rely on the plaintiff's status as a borrower as the source of a covenant of good faith and fair dealing. The plaintiff's status as a director was the main focus of the trial, but in light of the ultimate recognition by the California Court of Appeal that there is no cause of action for "wrongful ouster" of a director, no covenant of good faith and fair dealing may be implied from the plaintiff's status as a director. The plaintiff never even alleged, in his lengthy first amended com-

plaint, a document with numerous causes of action, that there was any contract between him and the Riverside National Bank.

In the absence of a contract there can, of course, be no breach of the covenant of good faith and fair dealing. *Peterson Development Company v. Torrey Pines Bank*, 233 Cal.App.3d 103, 116, 284 Cal.Rptr. 367 (1991), *review denied* (1991); *Careau & Company v. Security Pacific Business Credit, Inc.*, 222 Cal.App.3d 1371, 1393, 1401, 272 Cal.Rptr. 387 (1990). In *Foley v. Interactive Data Corporation*, 47 Cal.3d 654, 254 Cal.Rptr. 211, 765 P.2d 373 (1988), the California Supreme Court noted that the "covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, [and] not to protect some general public policy interest not directly tied to the contract's purposes." 47 Cal.3d at 690.

In *Racine v. Laramie, Ltd. v. Department of Parks and Recreation*, 11 Cal.App.4th 1026, 14 Cal.Rptr.2d 335 (1992), the Court of Appeal reversed a judgment of nearly $600,000.00, which was based upon the jury's finding that the defendant breached the implied covenant of good faith and fair dealing. The Court of Appeal also directed the trial court to enter judgment notwithstanding the verdict in favor of the defendant. 11 Cal.App.4th at 1035.

Several years after entering into a contract bearing many attributes of a long term lease, the plaintiff and the defendant in *Racine* commenced negotiating modifications to the contract. These negotiations occurred over a period of five years, and resulted in various drafts of proposed amendments to the contract. The plaintiff sued when the negotiations broke down, just as the plaintiff did here when his loans were not renewed. The plaintiff's position was that the defendant failed to negotiate in good faith, in violation of the covenant of good faith and fair dealing implied in the contract.

The Court of Appeal reversed the judgment because the contract did not *expressly obligate* the defendant to negotiate a

modification. 11 Cal.App.4th at 1031, 1032. The Court of Appeal added:

> "[The defendant's] commencement and continuance of negotiations over a long period of time had no effect upon this lack of obligation, and . . . its assumption of an arbitrary stance at some point in the negotiations cannot therefore be a breach of any contract term, including implied contract terms of good faith and fair dealing, even though such conduct might be found by a jury to be unreasonable, unfair, or otherwise bad faith negotiation tactics." 11 Cal.App.4th at 1031.

As is made clear in *Peterson Development Company v. Torrey Pines Bank*, 233 Cal.App.3d 103, 116, 284 Cal.Rptr. 367 (1991), a breach of contract and a breach of the implied covenant of good faith and fair dealing give rise to two completely separate causes of action. Moreover, no cause of action for breach of the implied covenant can exist in the absence of an "underlying contract." 233 Cal.App.3d at 116.

The lengthy trial in this case was devoted mainly to the "illegal ouster" theory, which is invalid as a matter of California law, as the Court of Appeal was ultimately forced to concede. Thus, no implied covenant of good faith and fair dealing could attach to the plaintiff's status as a director. The loan documents did not contain any term or condition that was violated by the Riverside National Bank, nor did they impose any obligation to renew loans or make new ones. Thus, the loan documents did not represent contracts to which the covenant of good faith and fair dealing could be attached. Thus, the Court of Appeal was forced to direct its attention to a different contract. It found that there had been an "oral" or "implied" contract to make or renew loans, a legal theory that never came up in the course of the present litigation until 1993, more than seven years after the commencement of the lawsuit and more than four years after the trial.

II.

No Cause of Action of the Plaintiff Is in Any Way Independent of the Breach of the "Oral" or "Implied" Contract to Renew the Plaintiff's Loans, Which Contract the Court of Appeal Found to Exist.

Without the newly discovered claim of breach of contract, the entire case of the plaintiff collapses like a house of cards. In his opposition brief in this court, the plaintiff persists in arguing that the defamation claims and other claims maintained by him are independent of the alleged "oral" or "implied" contract to renew the plaintiff's loans. Nothing could be further from the truth. If there was no "contract" to renew loans, then there was no contract to which the implied covenant of good faith and fair dealing could have attached. Unless there was a breach of the duty to renew loans, there was nothing defamatory in press reports that indicated that the plaintiff had been "ousted" as a director because of his failure to repay loans that were due. It is not libelous to describe a deadbeat as a deadbeat. Regardless of whether the plaintiff was current on his interest payments at various times, he had not repaid the principal of any loan at the time of the allegedly defamatory newspaper articles. If he was obligated to repay, pursuant to the loan documents, and had no automatic right to renewal, then he was in default, and the press coverage was truthful and accurate.

The remaining causes of action, not analyzed by the Court of Appeal, included interference with contractual relationships, interference with prospective economic advantage, and negligent interference with contractual relationships. All of these claims were dependent upon the validity of the "wrongful ouster" cause of action (which has been found to lack legal substance), or breach of the supposed contractual duty to renew loans. The clearest indication of the interdependence of the claims of the plaintiff is the operative first amended complaint. The first cause of action for "illegal ouster" is incorporated, in its entirety, in all of the subsequent subsidiary causes of action.

III.

The Finding by the Court of Appeal of Breach of Contract on the Part of the Defendants Represented the First and Only Notice to the Defendants That They Could Be Held Liable on Such a Theory.

As previously demonstrated, the breach of contract claim, upheld by the Court of Appeal although never even pleaded by the plaintiff, is essential to the entire case of the plaintiff, but is separate from the cause of action for breach of the implied covenant of good faith and fair dealing. Until the second Court of Appeal decision, the implied covenant was attached to the plaintiff's status as a director and to his loan documents. Since these theories failed, the Court of Appeal invented a new contract to which it attached the implied covenant. In the long history of the case, until the time of the ultimate appellate decision in California, no contract to renew loans had even been pleaded, much less proved.

In his opposition brief in this court, the plaintiff refers to certain selected passages in the prior appellate briefs of the defendants. These references to the claimed right of loan renewal all involve evidence and legal discussion pertaining to the "illegal ouster" and other claims, and do not relate to any contract theory. There was no contract theory in the case until the last Court of Appeal decision. There never was any contention on the part of the plaintiff that the Riverside National Bank had a legal obligation to renew the loans made to the plaintiff, which the plaintiff had been unable to repay.

The few cases cited by the plaintiff with respect to the notice issue are all easily distinguished. In *Frangos v. Doering Equipment Corporation*, 860 F.2d 70 (3d Cir. 1988), the defendant consented to the trial of a new legal theory and to an amendment at the trial court level of the pleadings of the adverse party. Similarly, in *Davis & Cox v. Summa Corporation*, 751 F.2d 1507 (9th Cir. 1985), the court relied upon the fact that the

parties may consent to the trial of an issue outside the pleadings, but noted that the trial judge must make a finding of such consent. In the present case, there was no consent on the part of the defendants to the trial of any contract claim against them, and the trial judge made no finding of such consent. Furthermore, the special verdict of the jury contained no finding on any contract theory, and it is therefore impossible to say that the contract liability discovered by the Court of Appeal in 1993 was actually tried in 1989.

In *Oglala Sioux Tribe of Indians v. Andrus*, 603 F.2d 707 (8th Cir. 1979), and in *Self Directed Placement Corporation v. Control Data Corporation*, 908 F.2d 462 (9th Cir. 1990), there were sufficient facts alleged to put the defendants on notice of the substance of the claims against them, so that they were able to prepare their defenses. In contrast, the defendants in the present case never received any notice whatsoever that they were alleged to have a legal obligation to renew the loans previously extended to a deadbeat director, an insider at the Riverside National Bank. The breach of contract theory never even entered the litigation until the second decision of the Court of Appeal in late 1993.

IV.

The Defendants Properly Preserved Their Federal Issues at the Earliest Opportunity Available.

In his opposition brief in this court (at pages 11-12), the plaintiff makes the incredible assertion that the defendants failed to comply with rule 14.1(h) of the *Rules of the Supreme Court of the United States*, by failing to point out how and in what manner the federal issues presented by defendants were preserved in the lower courts. This statement is plainly incorrect.

As noted above, the defendants first received notice of the supposed contract to renew loans at the time of the second Court of Appeal decision in late 1993. They raised the constitutional propriety of lack of notice of the claim at the earliest

possible opportunity, in their petition for rehearing in the Court of Appeal. A copy of the petition for rehearing is appendix G to the defendants' petition for a writ of certiorari, and the constitutional issue of notice is discussed at pages G2 through G5. Furthermore, the defendants had no opportunity to argue that the newly discovered contractual duty violated federal statutory law until the time of their petition for rehearing, when the argument was first made. (See appendix G, page 18.)

V.

This Case Is of Sufficient Public Importance to Warrant the Granting of a Writ of Certiorari.

In his opposition brief, the plaintiff argues that the present case is unimportant, and that certiorari should be denied for this reason, regardless of any merit in the legal contentions of the defendants. It is respectfully submitted that the plaintiff is wrong.

For decades, the decisions of this Court have upheld the constitutional requirement of notice as a prerequisite to imposition of financial liability on the part of a defendant. Here, there was no notice at all of the contract theory on which a massive judgment has now been upheld. The contract claim was never pleaded or proved, and defendants had no opportunity to respond to it. It was invoked at the eleventh hour, because of legal infirmity in the causes of action on which the plaintiff actually prevailed. The present judgment, with interest and attorneys' fees, now has a value of almost eight million dollars. This court should not permit a forfeiture of this magnitude, which is based upon a clear violation of the constitutional right of notice.

In addition to violating the Constitution, the contract claim, which is the foundation of the present judgment, violates federal banking law. A state has, in effect, imposed a legal duty to renew loans to an insider, a director who has been unable to pay his debts. After the trial, plaintiff's other creditors filed

massive liens, which exceeded even the multi-million dollar award in favor of the plaintiff.

Federally chartered banks are regulated in many areas, including procedures for making loans. If a state may impose a duty to make a loan, based solely on a contract implied from a course of conduct, or an alleged oral agreement, then the province of federal law is invaded. In this era of shaky financial institutions, insider deals of much smaller magnitude than the loans made to the plaintiff have attracted widespread public attention. If the present judgment stands, a bank will have been punished for refusing to renew loans to an insider, rather than for making insider loans. A federally chartered bank should not be punished for doing the right thing. The loans made to the plaintiff, a deadbeat director, should not have been renewed, and the Bank should not suffer for refusing to renew them.

Lender liability litigation is rampant in California. It is based primarily on the curious California cause of action known as breach of the implied covenant of good faith and fair dealing. Whatever the merits of the covenant theory in other cases, it cannot be properly invoked here, because there never was any breach of contract claim asserted in a manner consistent with the federal Constitution and with federal statutes regulating the banking industry.

VI.

Conclusion.

For the foregoing reasons, and for the reasons previously stated in defendants' petition in this court, it is respectfully submitted that certiorari should be granted. An eight million dollar liability, in violation of the federal Constitution as well as federal statutory law, must not be permitted to stand.

Respectfully submitted,

HAIGHT, BROWN & BONESTEEL,
Roy G. Weatherup, and
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ROY E. WHITEHEAD

PROOF OF SERVICE BY MAIL

State of California

ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen (18) years and not a party to the within action or proceeding; that my business address is 9105 Sunset Boulevard, West Hollywood, California 90069; that on May 26, 1994, I served the within *Reply to Brief in Opposition to Petition For Writ of Certiorari* in said action or proceeding by depositing true copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed on May 26, 1994, Los Angeles, California.

David Soto
(Original Signed)

Tavaglione on or about May 16, 199- [illegible] respectfully urged